

Kathleen Grillo
Vice President
Federal Regulatory



1300 I Street, NW, Suite 400 West
Washington, DC 20005

Phone 202 515-2533
Fax 202 336-7922
kathleen.m.grillo@verizon.com

February 17, 2005

EX PARTE

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

**RE: In the Matter of Federal-State Joint Board on Universal Service, CC Docket
No. 96-45**

Dear Ms. Dortch:

On February 16, 2005, Kathleen Grillo and Ann Rakestraw of Verizon, met with Jennifer Manner, Legal Advisor to Commissioner Kathleen Abernathy. The purpose of the meeting was to discuss the Recommended Decision of the Federal-State Joint Board on Universal Service concerning the process for designation of eligible telecommunications carriers. The attached presentation formed the basis of the discussions.

Please contact me if you have any questions.

Sincerely,

A handwritten signature in black ink that reads "Kathleen Grillo". The signature is fluid and cursive, with the first name and last name clearly distinguishable.

Attachment

cc: Jennifer Manner

Revising the Rules Regarding Portability of Rural High-Cost Support

February 2005



The Commission Must Control The Growth Of The Rural High Cost Fund

- The USF contribution factor is at its highest level ever, reaching 10.7% for First Quarter 2005
- The Commission must control growth of the USF to make support sustainable and services for all customers “affordable”
- The high cost fund accounts for almost half of USF support, with high cost loop support to rural carriers constituting the largest portion
- Rural high cost support should be no more than necessary to ensure that customers in rural areas have access to services at rates that are “reasonably comparable” to urban areas

Current High Cost Fund Growth

- Support to both rural LECs and competitive ETCs has been increasing; rural high cost support has grown from \$1.5 billion in 1999 to a projected \$2.9 billion in 2005

- **Funding to Rural LECs.**

- Approximately 16% of growth in the rural high cost fund in the last two years was for rural LECs, which are projected to receive almost \$2.5 billion in 2005
- Current rural high cost mechanism creates no incentives for LECs to operate efficiently

- **Funding to Competitive ETCs.**

- More than 80% of growth in rural support in recent years is due to competitive ETCs
- Competitive ETCs are projected to receive almost \$440M in 2005, compared to less than \$70M in 2003; funding in rural areas could grow by as much as \$400M more if pending ETC applications are granted
- 10 ETC petitions were filed with the FCC in 2001; by 2004, 295 competitive ETCs were operating in rural areas

Problem: As Number of ETCs Grows, So Does The Size of the Rural Fund

- Currently, the growth in total high cost loop support for rural carriers increases by the growth in supported rural loops. *See* 47 C.F.R. 36.603(a)
- Funding to competitive ETCs increases the fund size in one of two ways:
 - As competitive ETC lines supplement, rather than replace, LEC lines, more lines are funded.
 - When competitive ETC lines replace rural LEC lines, as the LEC loses lines, the per line rate for both the LEC and competitive ETC may increase to allow the LEC to recover the same costs from fewer lines. The result is that both the rural LEC and competitive ETC receive higher per-line support.

Solution: Limits on Number of ETCs and Level of Support Per Study Area

- Adopt a rebuttable presumption that there should be only one ETC per rural study area
- Freeze support per study area, rather than per entire fund size, with total support being no more than rural LEC would receive
- Allow support levels to increase only for growth in households, not supported lines
- Revise rules so that an increase in the number of ETCs per study areas does not lead to a corresponding increase in USF support

Adopt A Rebuttable Presumption of One ETC Per Rural High Cost Study Area

- As several commissioners have noted, it makes little sense to subsidize multiple competitors in areas where it is prohibitively expensive for even one carrier to operate
- Using universal service funds to artificially “create” competition by funding multiple ETCs in rural high cost areas may make it difficult for any one carrier to achieve necessary economies of scale
- In most rural areas where competitive ETCs are designated, carriers already were serving customers without USF support, showing such support is not necessary

Implementing Presumption of One ETC Per Rural High Cost Study Area

- In areas where more than one ETC exists, FCC or state will institute a proceeding to determine whether any ETCs should be decertified
- Commission should clarify that it normally will not be in the public interest to grant ETC status to more than one carrier per rural study area, as it unnecessarily dilutes USF support from intended purposes
- In study areas where a commission determines that it is in the public interest to have more than one ETC, support will be capped at the level that would have been received by the rural LEC

Limits Are Consistent With Congressional Directives

- Congress specifically recognized that it may not be in the public interest to have more than one ETC per rural study area. *See* 47 U.S.C. 214(e)(2).
- Recent appropriations language only prohibits implementing recommendations “regarding single connection or primary line restrictions”
 - Under one ETC rule, customer can receive multiple lines from the ETC that are supported by USF

Rural High Cost Support Should Be Capped Per Study Area

- Current caps on high cost support are ineffective
 - Support increases as the number of lines increases
 - No incentive to control the number of ETCs, because as more rural ETCs are designated in a state, the state receives a higher percentage of USF support
- Cap should be revised to:
 - Change national cap on rural support to a cap at the study area level, ensuring that public interest determination considers impact to USF support
 - Provide no more support than the rural LEC would have received had there been no competitive ETCs
 - Adjust future support levels based on changes in number of *households*, not *lines*, supported